OVERVIEW

International Developments

During October 2006, the US dollar, on average, appreciated against all major currencies. US dollar sentiment, at the start of the month, was hurt by expectations that a sluggish US economy could prompt the US Federal Reserve to cut interest rates following the release of data on September 2006 manufacturing growth which slowed to its weakest pace in 16 months. However, the subsequent release of data showing a large upward revision in August 2006 jobs payrolls and a decline in September's unemployment rate to 4.6 per cent, suggesting that the employment situation was still solid, helped to ease worries about a slowing US economy, thereby boosting the US dollar. Meanwhile, the minutes of the Fed's 20 September 2006 FOMC meeting highlighted the central bank's policy-makers' concerns about inflation risks and their commitment to control inflationary pressures. The release of other strong economic data, including the University of Michigan's consumer sentiment, capital inflows and new housing starts, further dampened expectations for the US Federal Reserve to cut interest rates early next year. On 25 October 2006, in a widely expected move, the US Federal Reserve at its FOMC meeting kept its federal funds rate unchanged for the third consecutive time at 5.25 per cent. In its post-meeting statement, the Fed said that the US core inflation rate had been high but thought this should ease because there was less impact from higher energy prices, inflation expectations were contained, and prior rate rises had put a restraint on spending. The Fed's warning on inflation, less harsh than expected and suggesting rather that US interest rates would be on hold for some time, also weighed on the US dollar. By the close of the month, the release of data on third quarter 2006 economic growth, which slowed to a lower-than-expected 1.6 per cent, its weakest pace in over three years, thereby strengthening expectations that the Fed would not raise interest rates again and even stirring some speculation that they might even cut rates in early 2007, added further pressure on the dollar.

The euro weakened against the US dollar during October 2006, trading at an average of US$1.2622 from an average of US$1.2743 in September 2006. The single currency hit its intra-month high of US$1.2745 at the start of October 2006, deriving support from a survey showing robust growth and rising inflation in the manufacturing sector, which reinforced expectations for further rate rises. However, the euro subsequently shrugged off its gains, indirectly undermined by speculation over possible euro-selling intervention from either the Japanese or European monetary authorities. As widely expected, on 5 October 2006, the European Central Bank (ECB) raised its key refinancing rate by 25 basis points to 3.25 per cent. Despite the rate hike, the euro remained under pressure against the US currency, as in his post-meeting statement ECB President Jean-Claude Trichet provided no clear signal for further tightening beyond an expected rise in December 2006. The general downward trend of the euro against the US currency was maintained and the single currency hit its intra-month low of US$1.2505 on 16 October 2006. The euro thereafter managed to recoup its losses against the US dollar to close October 2006 trading around US$1.2712.

The Pound sterling moved lower against the US dollar during October 2006, trading at an average of US$1.8749 from an average of US$1.8876 in September 2006. Starting October 2006 at US$1.8709, the British currency moved higher against the US dollar following the release of a robust survey of manufacturing activity, which hardened the case for a November 2006 interest rate rise. The Pound sterling thereafter came under pressure against the US dollar after the Bank of England, as expected, left its key repo rate steady at 4.75 per cent on 5 October 2006, disappointing those who were betting on the outside chance of a rate rise. The Pound sterling reached its intra-month low of US$1.8549 on 11 October 2006 amid the release of data showing a wider-than-expected trade deficit of GBP6.733 billion in August 2006 from an upwardly revised GBP6.785 billion in July 2006. The British currency thereafter recouped some of its losses, supported by strong UK house price data as well as firm inflation figures that bolstered expectations for a Bank of England interest rate rise in November 2006, and possibly beyond. Minutes of the Bank of England's 4-5 October 2006 policy meeting showed that the two newest members of the Monetary Policy Committee, Timothy Besley and Andrew Sentance, voted for a rate hike from the current 4.75 per cent. In addition, comments by Charles Bean, the Bank of England's chief economist, who said that policy-makers should take no chances with inflation, further cemented expectations for a rate rise by the Bank of England in November 2006. The British currency continued to move higher against the US dollar after UK Finance Minister Gordon Brown indicated in an interview with the Financial Times that Britain's economic growth in 2006 would exceed his forecast range of 2.0 per cent to 2.5 per cent and after the UK National Institute of Economic and Social Research said that inflation should fall back to the Bank of England's 2.0 per cent target by the end of next year if rates were to rise by another 50 basis points. Strong data on British mortgage lending, money supply and house prices also heightened expectations of a near-term interest rate hike. The Pound sterling closed October 2006, trading at its intra-month high of US$1.8992.

The Japanese yen depreciated against the US dollar during October 2006, trading at an average of ¥118.63 per US dollar from an average of ¥117.03 per US dollar in September 2006. At the start of October 2006, the Japanese yen was undermined by heightened tension in northeast Asia following a report that North Korea had carried out an underground nuclear test. The Japanese yen slipped further against the US dollar as rumours circulated in the market that a second nuclear test had been completed. On 13 October 2006, the Bank of Japan, as widely expected, left interest rate unchanged at 0.25 per cent at the end of its two-day policy meeting. The Japanese yen hit its intra-month low of ¥119.64 per US dollar on 16 October 2006. Thereafter, the Japanese currency recouped its losses after Alexei Ulyukayev, Russia's first deputy central bank chairman, said that the bank had started buying yen for its reserves, aiming to bring the Japanese currency's share to "several percent" from close to zero. The yen also benefited from comments made by Hiroshi Watanabe, vice finance minister for international affairs, who said that he did not expect the yen to weaken further given Japan's healthy economic fundamentals. The Japanese currency also gained support from speculation that the Swiss National Bank was adding yen to its reserves. On 30 October 2006, the Japanese yen hit its intra-month high of ¥117.39 per US dollar before closing the month trading at ¥117.49 per US dollar.

Oil prices, on average, continued to fall during October 2006 as reports from the US Energy Information Administration showed remarkable increases in US crude stock levels. News that British Petroleum had restarted its operations at the Lisburne field in Alaska lowered oil prices. Fund selling further pressured oil prices downward. OPEC members, worried about the slide in oil prices, reacted by calling for output cuts. But, due to uncertainty over a plan to cut output by 1 million barrels per day, these calls had little impact on oil prices. On 19 October, OPEC members finally agreed at an emergency meeting to cut output by 1.2 million barrels per day effective 1 November 2006. But the decision had only temporary impact on the market as oil prices continued to fall. Moreover, Chinese official data released in the last week of October 2006, showing that implied oil demand in China was growing at a modest rate of 3 per cent, pushed prices further down. In the weeks ahead, oil prices will most likely trade around US$60 a barrel.

NYMEX WTI (West Texas Intermediate benchmark crude oil) averaged US$59.1 a barrel in October 2006, down from US$63.9 a barrel in September 2006 and US$62.3 a barrel in October 2005. IPE Brent futures averaged US$59.8 a barrel during the period under review, down from US$63.6 a barrel in September 2006 but up from US$59.5 a barrel in October 2005.

COMEX gold futures, on average, moved lower during October 2006, trading in an intra-month closing range of US$566.7/Oz-US$607.4/Oz compared to a range of US$583.0/Oz-US$646.9/Oz in September 2006. Gold prices continued to be influenced more by speculative moves than fundamental demand and supply factors. Fund selling amid lower oil prices drove prices down. Moreover, the fact that the bullion was unable to cross the US$600/Oz-level for some time, kept the gold contract under pressure. COMEX averaged US$589.6/Oz during October 2006, compared to an average of US$603.9/Oz in September 2006.

Domestic Developments

Tourist arrivals grew by 5.5 per cent, from 53,233 in September 2005 to 56,138 in September 2006, while gross tourism receipts went up by 23.4 per cent, from Rs1,779 million in September 2005 to Rs2,195 million in September 2006. Cumulatively, over the period January to September 2006, tourist arrivals reached 546,122, representing a rise of 3.3 per cent over the 528,752 arrivals recorded in the corresponding period of the previous year. Tourism receipts for the period January to September 2006 increased by 22.5 per cent to reach Rs22,058 million compared to Rs18,012 million recorded over the corresponding period in 2005.

The Consumer Price Index (CPI) increased from 131.7 in September 2006 to 132.3 in October 2006. Except for “Alcoholic Beverages and Tobacco” whose sub-index declined by 0.3 per cent, and “Food and Non-Alcoholic Beverages”, “Education” and “Restaurants and Hotels” with no change in their sub-indices, the remaining eight Divisions recorded increases in their sub-indices. Both “Communication” and “Transport” registered the largest rise of 1.8 per cent followed by “Housing, Water, Electricity, Gas and Other Fuels” (+1.2 per cent). The remaining five Divisions recorded increases in the range of 0.1 to

0.7 per cent. The main contributors to the change in the index between September 2006 and October 2006 were gasoline, which rose by 0.4 index point and milk, other food products, cooking gas, postal services, other goods and services, each registering an increase of 0.1 index point. However, these increases were partially offset by declines of 0.1 index point in fruits, eggs and diesel oil. The rate of inflation for the twelve-month period ended October 2006 stood at 7.5 per cent, up from 6.8 per cent for the twelve-month period ended September 2006.

While headline inflation for October 2006 stood at 7.5 per cent, CORE1, CORE2 and TRIM10 inflation rates stood at 6.0 per cent, 6.4 per cent and 5.8 per cent, respectively. Consequently, for October 2006, core inflation was between 1.1 and 1.7 percentage points lower than the headline inflation.

Money supply M2 expanded by Rs3,356 million or 1.9 per cent, from Rs177,527 million at the end of June 2006 to Rs180,883 million at the end of September 2006 reflecting increases in both quasi money and narrow money supply. Narrow money supply M1 went up by Rs636 million or 2.5 per cent to Rs25,705 million while quasi-money increased by Rs2,720 million or 1.8 per cent to Rs155,178 million.

Net foreign assets of the banking system grew by Rs6,682 million or 10.9 per cent, from Rs61,435 million at the end of June 2006 to Rs68,117 million at the end of September 2006. Net foreign assets of Bank of Mauritius increased by Rs561 million or 1.3 per cent to Rs43,015 million while net foreign assets of banks rose by Rs6,121 million or 32.2 per cent to Rs25,102 million over the same period.

Domestic credit grew by Rs4,655 million or 2.8 per cent, from Rs164,961 million at the end of June 2006 to Rs169,616 million at the end of September 2006. Net credit to Government from the banking system contracted by Rs1,403 million or 3.1 per cent, from Rs45,490 million at the end of June 2006 to Rs44,087 million at the end of September 2006. Net credit to Government from Bank of Mauritius went up by Rs1,867 million or 113.8 per cent to Rs3,508 million while net credit to Government from banks contracted by Rs3,270 million or 7.5 per cent to Rs40,579 million. Credit to the private sector expanded by Rs6,058 million or 5.1 per cent, from Rs119,471 million at the end of June 2006 to Rs125,529 million at the end of September 2006. Between end June 2006 and end September 2006, additional credit was extended to “Financial and Business Services” (Rs1,519 million), “Public Nonfinancial Corporations” (Rs1,253 million), “Tourism” (Rs696 million), “Construction” (Rs676 million), “Traders” (Rs658 million), “Personal” (Rs558 million), “Infrastructure” (Rs439 million), “Transport” (Rs146 million), “Manufacturing” (Rs102 million), “Education” (Rs42 million), “Health” (Rs26 million) and “Agriculture & Fishing” (Rs26 million). Over the same period a decline of Rs60 million was recorded at both the “Freeport Enterprise Certificate Holders” and “Professional” sectors.

Reserve money grew by Rs272 million or 1.1 per cent, from Rs24,543 million at the end of June 2006 to Rs24,815 million at the end of September 2006.

The Bank issued Government of Mauritius Treasury Bills/Bank of Mauritius Bills for a total amount of Rs3,107 million through the Primary Market in October 2006. No repurchase transaction was undertaken by the Bank.

During October 2006, total transactions in Government of Mauritius Treasury/Bank of Mauritius Bills effected through primary dealers amounted to Rs835.6 million. There was no trading of Treasury Bills on the Stock Exchange of Mauritius.

At the monthly auction of Treasury Notes held in October 2006, a total nominal amount of Rs800 million of Treasury Notes with maturities of 2, 3, and 4 years and with interest payable semi-annually at the rates of 8.50, 8.90, and 9.15 per cent per annum, respectively, were put on tender. Bids were received for a total amount of Rs709.9 million, of which an amount of Rs707.9 million was accepted. The weighted average yields on bids accepted were 10.71, 10.89, and 11.04 per cent per annum, respectively.

The second issue of Five-Year Government of Mauritius Bonds for 2006-07, which was initially scheduled on 20 October 2006, was undertaken on 27 October 2006, through an auction held on 25 October 2006. Bonds for a total nominal amount of Rs500 million were put on tender at a coupon rate which was set at a rate equal to or higher than the lowest accepted yield of the auction. Bids were received for a total amount of Rs774.3 million, of which Rs500 million were accepted. The weighted average yield on bids accepted was 11.83 per cent per annum and the coupon rate was set at 11.50 per cent per annum.

In October 2006, the Bank intervened and sold US dollars for a total amount of US$15.4 million on the interbank foreign exchange market.

Between September 2006 and October 2006, the rupee, on average, appreciated vis-à-vis the Japanese yen but depreciated against the US dollar, euro and the Pound sterling.

At the end of September 2006, the net international reserves of the country amounted to Rs68,684 million. The end-September 2006 level of net international reserves of the country, based on the value of the import bill for fiscal year 2005-06, exclusive of the purchase of aircraft, represented 35.4 weeks of imports, up from 33.8 weeks of imports at the end of August 2006. The gross foreign exchange reserves of the Bank of Mauritius decreased from Rs43,015 million at the end of September 2006 to Rs41,841 million at the end of October 2006, reflecting Government's decision to shift a significant portion of its foreign exchange balances from the Bank of Mauritius to a commercial bank and also intervention by the Bank on the foreign exchange market.

Provisional estimates indicate that foreign direct investment (FDI) in Mauritius for the first nine months of 2006 stood at Rs3,410 million. Investment was mainly directed to the tourism sector (Rs2,259 million), mostly under the Integrated Resorts Scheme (IRS). The main sources of FDI inflows to Mauritius were the United Kingdom (Rs712 million) and Switzerland (Rs545 million). Outward FDI was estimated at Rs705 million for the first nine months of 2006 with significant investment directed to the agricultural sector in Mozambique (Rs256 million) and the tourism sector (Rs214 million) in the Maldives and the Seychelles. Madagascar also benefited from investment in its manufacturing sector from Mauritius to the tune of Rs158 million.